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PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

**Telecommunications Division
Market Structure Branch**

**RESOLUTION T-16913
January 27, 2005**

R E S O L U T I O N

Resolution T-16913. SBC California (U-1001-C). Request for Approval of Price Cap Mechanism, in Compliance with Decision 89-10-031, and Corresponding Adjustments to Surcharges which will be Effective on February 1, 2005.

By Advice Letter No. 25578 Filed on October 1, 2004.

Summary

This Resolution authorizes SBC California (SBC) to decrease its annual revenues by \$8.822 million effective February 1, 2005. A summary of the price cap filing calculation of the adopted revenue adjustment is shown in Appendix A. A summary of the adopted surcredit is shown in Appendix B.

SBC requested an annual revenue decrease of \$8.822 due to the impacts of one-time adjustments caused by the Modification of An Exchange Boundary, Gain on Sale of Land, Intervenor Compensation and Tier II Payments. Because of the larger revenue decrease this year than in last year's price cap resolution, the effect of SBC's proposal will lead to higher surcredits in 2005, effective February 1, 2005, than in 2004. Customers will, therefore, pay less for service in 2005 than in 2004. The impact of SBC's proposal on customer bills is shown in Appendix B to this resolution.

Background

New Regulatory Framework

In Decision (D.) 89-10-031 the Commission adopted an incentive-based regulatory framework (called the new regulatory framework or "NRF") for Pacific (now known as SBC California) and GTE California Incorporated/GTEC (now known as Verizon California Incorporated). The decision stated that prices and rate caps would be

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indexed annually according to the Gross National Product Price Index (GNP-PI) inflation index reduced by a productivity adjustment.

The indexing formula allowed rate adjustments for a limited category of exogenous factors, called Z-factors, whose effects are not reflected in the GNP-PI. Only specific types of costs were considered Z-factors: changes in federal and state tax laws to the extent they affect the local exchange carriers disproportionately, mandated jurisdictional separations changes, and changes to intraLATA toll pooling arrangements or accounting procedures adopted by this Commission.

However, the Commission did not authorize Z-factor treatment for all unforeseen or exogenous factors. In D.89-10-031, the Commission stated that normal costs of doing business (including costs of complying with existing regulatory requirements) or general economic conditions would be excluded as Z-factor items.

The Price Cap indexing formula has been modified since being adopted in D.89-10-031. In D.94-06-011, the Commission ordered Pacific to replace the GNP-PI with the Gross Domestic Product Price Index (GDP-PI), and in D.94-09-065, the Commission authorized Pacific and GTEC to implement the 1995 price cap rate adjustments through the billing surcharge/surcredit mechanism.

In 1995, the Commission issued D.95-12-052 regarding the second triennial New Regulatory Framework review and suspended the application of the GDP-PI minus productivity factor formula used in price cap regulation of Pacific and GTEC.

In October 1998, the Commission issued D.98-10-026 regarding the third triennial review of the NRF. The order continues the suspension of the GDP-PI minus productivity factor formula, suspends for the first time the sharing mechanism, permanently eliminates the depreciation review, replaces Z-factors with limited exogenous (LE) factors, and continues rate caps on residential services by keeping all rate caps and floors.

The order also specifies that, in the future, LE cost recovery is confined to recovery for cost increase or decreases resulting from (1) items mandated by the Commission and (2) changes in total intrastate recovery resulting from changes between federal and state jurisdiction. Recovery of Commission mandated cost changes must be authorized in the underlying Commission Decision.

The Commission opened the fourth triennial review of NRF for SBC and Verizon on September 6, 2001 via a combined Order Instituting Rulemaking 01-09-001 and Order Instituting Investigation 01-09-002. Phase 2 of the review focused on a regulatory audit of SBC that addressed accounting, cost allocation, affiliate transactions and Yellow

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Pages directory ratemaking issues. Policy issues, such as the price cap indexing mechanism, are expected to be addressed in the upcoming Phase 3 of the review.

SBC's Price Cap Filing

On October 1, 2004, SBC filed its 2005 price cap advice letter (A.L. No. 25578) filing to comply with D.89-10-031. In this filing, SBC proposed to include the following adjustments to its revenues (reduction in parenthesis):

- **Modification of Exchange Boundary** **\$168,000**
This is a one-time LE Factor to reflect a change in an exchange boundary.
- **Gain on Sale of Land** **(\$921,000)**
This is a one-time adjustment to reflect the gains on sale of land.
- **Intervenor Compensation** **\$538,000**
This is a one-time adjustment to reflect recovery for participation or intervention in Commission Proceedings governed by the provisions of Division 1, Part I, Chapter 9, Article 5 (beginning with section 1807) of the Public Utilities Code.
- **Tier II Payments (OSS Performance Incentives)** **(\$8,608,000)**
This is a one-time adjustment to reflect payments to general ratepayers, including interest, as adopted by the Commission in D.02-03-023.
- **Total Revenue Adjustment** **(\$8,822,000)**

As shown above, the net result of the LE-Factors and One-Time Other Adjustments proposed by SBC is a decrease of \$8.822 million in Total Revenues.

Since the \$8.822 million will be refunded to its customers over eleven months in 2005 to be effective February 1, 2005, SBC will have interim surcredit rates effective January 1, 2005 and revised surcredit rates effective February 1, 2005.

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To refund this revenue to its customers, SBC requests authority to modify:

1. The current surcredit to be applied to all IntraLATA Exchange and Private Line Service with the exception of Category III Services and the taxes and surcharges currently listed in the tariffs from (1.377%) to (1.295%) effective 1/1/05 and then to (1.526%) effective 2/1/05.
2. The surcredit to be applied to all IntraLATA Toll Services currently listed in the tariffs from (1.379%) to (1.297%) effective 1/1/05 and then to (1.528%) effective 2/1/05.
3. The surcredit to be applied to all IntraLATA Access Services currently listed in the tariffs from (1.383%) to (1.301%) effective 1/1/05 and then to (1.532%) effective 2/1/05.

Notice/Protests

SBC states that a copy of the Advice Letter and related tariff sheets were mailed to competing and adjacent utilities and/or other utilities, and interested parties, as requested. Notice of Advice Letter No. 25578 was published in the Commission Daily Calendar on October 8, 2004.

On October 28, 2004, the Office of Ratepayer Advocates (ORA) filed a timely protest regarding Gain on Sale of Land. SBC responded to ORA's protest on November 5, 2004. The positions of both parties are summarized below under Gain on Sale of Land.

Discussion

Exchange Boundary Modification Costs

The Commission approved a settlement between the Board of Supervisors of Nevada County and SBC Pacific Bell. The terms of the settlement provided that residents of Nevada County currently served by the Yuba County Smartville telephone exchange will be provided a Nevada County Grass Valley exchange local calling area. This one-time adjustment covers Pacific's expenses for this project as authorized by the Commission in D. 03-04-007.

Gain on Sale of Land

SBC identified a total gain on sale of land in the amount of \$2,296,380 and proposes to refund to ratepayers \$920,950 after adjusting for interstate/intrastate separations. ORA filed a protest regarding SBC's reporting of gain on sale of land. ORA states that SBC

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failed to file a Section 851 filing consistent with Public Utilities Code Section 851. Section 851 requires Commission approval prior to the utility selling a utility asset if the asset is necessary or useful in the performance of the utility's duties to the public.

SBC argues that it followed the requirements for gain on sale of land set forth in the settlement agreement adopted by the Commission in D. 94-06-011. SBC also claims that Section 851 has no bearing on SBC's Advice Letter. Because the three land sales reflected in SBC's Advice Letter were for property not necessary or useful to SBC in the performance of its duties to the public, and therefore a Section 851 application was not required.

Decision 94-06-011 adopted the settlement agreement between Pacific Bell (now known as SBC) and the Division of Ratepayer Advocates (now known as ORA) in Application 92-05-004 as it relates to gain on sale of land. The settlement agreement, included as Appendix B to the Decision, states that for sales which occurred in 1997 and beyond, Pacific will return 50% of the gain on sale directly to ratepayers as one-time rate adjustments in the annual Price Cap filings; the remaining 50% will go to shareholders.

ORA cites that in D. 96-09-069, the Commission sets forth the Section 851 review requirements:

- To decide that the utility's asset is truly not useful or necessary so that the sales will not impair utility service
- To ensure that the sale will not cause public harm
- To ensure that the booking of the sale is properly recorded and the gain/loss is appropriately allocated between ratepayers and shareholders.

SBC rebuts ORA's cite of D. 96-09-069 since, according to SBC, that decision deals with circumstances generally involving (1) the utility's proposal to lease to affiliates unused portions of property also being used by the utility to provide service and (2) utility employees and their job functions being transferred to an affiliate which continued to provide the same services to the utility with the employees remaining in place at the same location.

However, D. 96-09-069 refers to D. 96-04-045, which applies to transactions with non-affiliates, and states that "any exchange transaction in which utility property is encumbered is subject to commission review and approval, whether such encumbrance comes in the form of a sale, a mortgage, a lease, or a sublease." In the section dealing with Section 851 Review, D. 96-04-045 explains that the Commission reviews Section 851 transactions to ensure that it will not impair the utility's ability to provide service to the public and to ensure that any revenue from the transaction is accounted for properly, and that the utility's rate base, depreciation, and other accounts correctly

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reflect the transaction.

ORA recommends that “the Commission should accept SBC CA’s AL 25578 only subject to modification, due to the fact that the upcoming NRF audit may impact the value of SBC CA’s gain on sale allocated to ratepayers.”

We do not believe that ORA has presented sufficient reason to approve SBC A.L. No. 25578 subject to modification, and we therefore decline to do so. We accept A.L. No. 25578 as filed.

Intervenor Compensation Recovery

Decision 96-04-063 confirmed that SBC (formerly Pacific) was entitled to recover intervenor compensation, but concluded that SBC’s rates shall remain subject to refund or adjustment pending completion of an OII. In Resolution T-16265, the Commission agreed that data provided by SBC appeared to demonstrate that there was no recovery of intervenor compensation in the start-up revenue period. Therefore, it would be equitable to allow SBC to recover intervenor compensation, in accordance with Decision 96-04-063, where the amount shall remain subject to refund or adjustment when the OII is terminated.

During the period of September 2003 through September 2004, SBC paid \$710,000 (including interest) for intervenor compensation awarded by the Commission. After applying the applicable intrastate separations factor of 75.78%, SBC request recovery of \$538,000. The Telecommunications Division (TD) recommends the adoption of SBC’s request to recover intervenor compensation through a one-time adjustment of \$538,000.

Tier II Payments

Decision 02-03-023 established monetary performance incentives for an incumbent local exchange carrier (LEC) to give competitors equitable access to the LEC’s Operations Support Systems (OSS) infrastructure. Under the Commission’s incentive plan, there are two types of payments for OSS performance levels that fall below Commission approved performance standards: Tier I which are generally paid to individual Competitive Local Exchange Carriers and Tier II payments which are paid to general ratepayers.

Tier II payments are calculated throughout the year and placed monthly into an interest bearing escrow account and remitted to ratepayers in the subsequent year in the form of a billing surcredit. A 2005 Tier II payment in the amount of (\$8.608) million for 2004 had been developed consistent with the methodology adopted by the Commission in D.02-03-023. TD recommends the adoption of SBC’s request to remit to ratepayers through the one-time adjustment of (\$8.608) million for the Tier II payments.

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Gross Domestic Product Price Index:

During the 2003 price cap filing, the CPUC requested that SBC include its inflation factor, the Gross Domestic Product Price Index (GDP-PI), as part of its workpapers. ORA noted that the GDP-PI is a necessary component to update price floors. SBC provided the GDP-PI data as part of its 2005 price cap filing.

Price Floor Update:

In the 2003 price cap resolution T-16717, the CPUC directed SBC to revise its price floor update format in subsequent price cap filings and include the following information for each of the services:

- The line number
- The cost basis
- Whether imputation is required
- Current average unit revenue
- Current price floor
- Proposed price floor
- Difference between current average unit revenue and the proposal price floor

SBC provided the Price Floor update in the format mentioned above and adopted in the 2003 price cap resolution T-16717TD has reviewed the price floor format and believes that the format comports with Resolution T-16717.

TD's analysis of SBC's price floor update found 38 instances where SBC's current tariffed rate is below the 2005 updated price floor. According to Ordering Paragraph 70 of D. 94-09-065, "if, as a result of the inflation adjustment, the adjusted price floor for a particular service exceeds the rate, the LEC must either raise the rate for the service or revise the price floor." In the course of reviewing this advice letter, TD asked SBC to discuss its plans to be in compliance with D. 94-09-065.

Below is SBC's response for the 38 services and other services in which SBC found errors:

1. SBC plans to file an Advice Letter to raise the price of three services to a level between the price floor and price ceiling.
 - Compact Disk Bill: CD Bill for Individual accounts – each disk
 - Compact Disk Bill: CD Bill for Stack Bill – parent account
 - Compact Disk Bill: CD Bill for Summary Bill – pilot account
2. For many of the services, SBC acknowledged incorrectly calculating the price

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- floor, incorrectly listing the wrong tariffed price or indicating the incorrect tariff schedule or sheet number. For these services, SBC filed corrected workpapers showing the price to be above the price floor.
3. SBC filed Application (A.) 00-09-061 to increase the price of three services to the price floor in September 2000. However, the application is still pending.
 - PBX Trunk Line Service: Assured – DID equipped
 - PBX Trunk Line Service: Assured – non DID
 - PBX Trunk Line Service: Basic – non DID
 4. For the majority of the services, the tariffed price is at the ceiling and the floor exceeds the ceiling rate. The prices for these services are therefore frozen and no longer have pricing flexibility according to Conclusion of Law 33 in D. 89-10-031. SBC addressed this issue in its Opening comments regarding pricing in Phase 3 of Rulemaking 01-09-001/Investigation 01-09-002. SBC recommended in its Opening Comments of Phase 3A “that the Commission require increases in the prices of any [retail] services that are currently priced below the approved price floors by advice letter, unless there is clear public policy basis for continuing the existing below-cost pricing.”

For the three services covered under Item #1 above, TD observes that SBC’s 2005 price floor update does not comply with D. 94-09-065 at this time because there are services where the floor exceeds the tariff price. D. 94-09-065 requires that if as a result of the inflation adjustment, the adjusted price floor for a particular service exceeds the rate, the local exchange carrier must either raise the rate for the service or revise the price floor using the 40-day advice letter process (Ordering Paragraphs 69 and 70).

TD believes that SBC should revise its 2005 price floor update to comply with D.94-09-065. Except for those services that are included in SBC’s A. 00-09-061 (Item #3 above) and those services for which prices are frozen (Item #4 above), TD recommends that SBC should file an advice letter in compliance with D. 94-09-061 to raise the price of the services to exceed the floor or revise the floor to be below the price, within 90-days of the effective date of this resolution.

For the Category II services where the price is at the ceiling and prices are essentially frozen pursuant to Conclusion of Law 33 in D. 89-10-031, TD points out that SBC has raised the issue of price floors exceeding the prices for certain services and recommends that we defer to NRF Phase 3 the process(es) to be employed for services with floors that are above the price.

Impact of Adopted Changes

For the year 2004, SBC was required to refund to customers \$3.928 million for adjustments that expired or ceased at the end of the year 2004. The \$8.822 million

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revenue reduction (subject to modification for the three land sales) adopted here for 2005 is larger than in 2004 and accordingly, the surcredit on customer bills will be higher as shown in Appendix B of this resolution. The effect of the higher surcredit is that customers will pay slightly less for telephone service in 2005, effective February 1, 2005, than they paid in 2004.

311 Mailing Of Draft Resolution

In compliance with PU Code Section 311(g), a notice letter was e-mailed on December 14 to the parties that this draft resolution is available at the Commission's website <http://www.cpuc.ca.gov> and is available for public comments. In addition, TD informed these parties of the availability of the conformed resolution at the same website. For those parties without e-mail address, this draft resolution was mailed in accordance with PU Code Section 311(g).

Comments filed on a timely basis are discussed below.

Comments to Draft Resolution T-16913

SBC filed comments on December 29, 2004. SBC claims that the resolution erred by "relying on ORA's irrelevant claims to make the revenue decrease adopted in the draft resolution subject to modification and to add new issues to the audit ordered in D. 04-09-061." SBC did not agree that there was a "controversy" as stated in the draft resolution regarding the sale of the three properties. As evidence of the non-controversy, SBC states that "SBC treatment of these properties in this filing is the same as in prior price cap advice letters, all of which have been approved" and that "ORA did not contend that SBC California failed to follow Commission's requirements for allocating gain on sale land. Thus, there is no dispute..."

SBC reiterates its claim (as it did in its response to the protest of ORA) that Section 851 filings for these three properties is "irrelevant because SBC California's Advice Letter simply implements the gain on sale of land requirements adopted in D. 04-06-061 and the Advice Letter has nothing to do with Section 851."

ORA and The Utility Reform Network (TURN) filed joint reply comments on January 5, 2005. The joint commenters state that "SBC California is wrong" because the "Commission has full authority to investigate whether SBC California has followed applicable regulatory requirements, in this case, a PU Code Section 851 requirement." The joint commenters disagree with SBC that "Section 851 filings are not required when the utility sells assets that are not necessary or useful". The joint commenters state that the "commission has made it very clear that it is for the Commission, not the utilities, to decide conclusively whether sold assets are truly not useful or unnecessary to the provision of utilities service." The joint commenters cite D. 04-09-029, dealing with

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Southern California Water Company, which states “in case after case, it is the Commission that determines, after a utility comes in for section 851 approval, that such approval is or is not required because the property is or is not necessary or useful to the company's public utility business.” The joint commenters also cite many Pacific Gas & Electric Company applications which relate to Section 851 filings and A. 04-06-022 of Kerman Telephone Company (Kerman) in which Kerman “filed a Section 851 filing to ask for the Commission’s approval to transfer property considered by Kerman to be not useful for the utilities services of its parent company.”

Despite these legal arguments, we do not believe that ORA and TURN have provided us with sufficient details regarding actual problems with SBC’s sale of property to warrant approving A.L. No. 25578 subject to modification and therefore decline to do so.

Findings

1. On October 1, 2004, SBC filed its price cap filing A.L. No. 25578, and requests the following one-time adjustments in its revenues:

• Modification of Exchange Boundary	168,000
• Gain on Sale of Land	(\$921,000)
• Intervenor Compensation	\$538,000
• Tier II Payments	(\$8,608,000)
• Total Revenue Adjustment	<hr/> (\$8,822,000)

2. SBC proposes that its billing base for calculating the 2005 surcharge/surcredit to be \$4,162,859,000.
3. Pacific’s surcredit rates will be calculated over an eleven month basis due to the February 1, 2005 effective date.
4. Effective February 1, 2005, SBC requests to adjust the \$8.822 million decrease in revenue requirements by applying:
 - a) a surcredit of (1.526%) applied to IntraLATA Exchange and Private Line Service with the exceptions of Category III Services, access charges listed in Schedule No. 1, and surcharges currently listed in Pacific’s tariffs.
 - b) a surcredit of (1.528%) applied to intraLATA toll (Schedule No. A2)
 - c) a surcredit of (1.532%) applied to access services (Schedule No. A2)

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5. ORA filed a protest regarding the gain on sale and recommended that SBC's A.L. 25578 be subject to modification, due to the fact that the upcoming NRF audit may impact the value of SBC CA's gain on sale allocated to ratepayers.
6. We adopt SBC's request to refund the ratepayers through a one-time adjustment of (921,000) for the gain on sale of land.
7. We find reasonable and adopt SBC's request to recover intervenor compensation through a one-time adjustment in the amount of \$538,000.
8. We find reasonable and adopt SBC's request to remit to ratepayers through the one-time adjustment of (\$8,608,000) for the Tier II payments.
9. We find reasonable and adopt SBC's request to recover costs due to modification of exchange boundary through a one-time LE Factor in the amount of \$168,000.
10. SBC provided additional information in the table reflecting price floor adjustments and included the GDP-PI as part of its work papers.
11. The revenue adjustments associated with Modification of Exchange Boundary, Gain of Sale of Land (subject to modification), Intervenor Compensation, and Tier II Payments result in a net revenue decrease of \$8.822 million to be applied to local, toll, and access services are summarized in Appendix A to this resolution.
12. Except for those services that are included in SBC's A. 00-09-061 and those services for which the prices are frozen, TD recommends that SBC shall file an advice letter in compliance with D. 94-09-065 to raise the price of the services to exceed the floor or revise the floor to be below the price within 90-days of the effective date of this resolution.
13. For the Category II services where the price is at the ceiling and prices are essentially frozen pursuant to Conclusion of Law 33 of D. 89-10-031, SBC has raised the issue of price floors exceeding the prices for certain services in NRF Phase 3 and recommends that we defer to NRF Phase 3 the process(es) to be employed for services with floors that are above the price.

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THEREFORE, IT IS ORDERED that:

1. SBC California shall decrease its annual revenues by the total proposed revenue adjustment of \$8.822 million.
2. SBC shall implement billing surcredits reflecting the revenue decrease ordered in Ordering Paragraph 1, applied to a total billing base of \$4,162,859,000 for intraLATA exchange and private line services, intraLATA toll services, and intraLATA access service, to become effective on February 1, 2005, subject to review and approval by the Commission's Telecommunications Division. Adopted surcredits are shown in Appendix B.
3. Except for those services that are included in SBC's A. 00-09-061 and those services for which prices are frozen, SBC shall file an advice letter in compliance with D. 94-09-065 to raise the price of the service to exceed the floor or revise the floor to be below the price within 90-days of the effective date of this resolution.

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This Resolution is effective today.

I hereby certify that the Public Utilities Commission adopted this Resolution at its regular meeting on January 27, 2005. The following Commissioners approved it:

STEVE LARSON
Executive Director

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APPENDIX A
Resolution T-16913
SBC California
2005 Price Cap Filing

One-Time Other Adjustments	SBC Proposed Revenue Impacts	Adopted Impacts
Modification of Exchange Boundary	\$ 168,000	\$ 168,000
Gain on Sale of Land	\$ (921,000)	\$ (921,000)
Intervenor Compensation	\$ 538,000	\$ 538,000
Tier II Payments	\$ (8,608,000)	\$ (8,608,000)
Total	\$ (8,822,000)	\$ (8,822,000)

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APPENDIX B
Resolution T-16913
SBC California
2005 Price Cap Filing

	Current Surcredit	SBC Proposed Surcredit	Adopted Surcredit
Local	(1.377%)	(1.526%)	(1.526%)
Toll	(1.379%)	(1.528%)	(1.528%)
Access	(1.383%)	(1.532%)	(1.532%)